

Lakes Regional Healthcare
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2011 and 2010

Together with Independent Auditor's Report

Lakes Regional Healthcare

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Lakes Regional Healthcare

Officials
June 30, 2011

<u>Board of Trustees</u>	<u>Address</u>	<u>Term Expires</u>
Denny Perry, Chairman	Spirit Lake, Iowa	December 2016
Kris Walker, Vice-Chairman	Arnolds Park, Iowa	December 2012
Doug Dingel, Secretary/Treasurer	Terril, Iowa	December 2014
Steve Feld	Milford, Iowa	December 2016
Dan Sedlacek	Spirit Lake, Iowa	December 2014
Deb Goetzinger	Spirit Lake, Iowa	December 2014
Mary Kay Bates	Spirit Lake, Iowa	December 2012
<u>Chief Executive Officer</u>		
Jason Harrington	Spirit Lake, Iowa	Indefinite
<u>Chief Financial Officer</u>		
Steve Alger	Spirit Lake, Iowa	Indefinite

Independent Auditor's Report

To the Board of Trustees
Lakes Regional Healthcare
Spirit Lake, Iowa:

We have audited the accompanying basic financial statements of Lakes Regional Healthcare (Hospital) as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of June 30, 2011 and 2010, and the results of its operations, changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2011 on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of the report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and Budgetary Comparison Information on pages 3 through 7 and page 23 are not required parts of the basic financial statements but are supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The other supplementary information, included in Exhibits 1 through 6, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Seim Johnson, LLP

Omaha, Nebraska,
October 14, 2011.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2011 and 2010

This discussion and analysis of Lakes Regional Healthcare's (LRH) financial performance provides an overview of financial activities for the fiscal years ended June 30, 2011, 2010 and 2009. This discussion and analysis should be read in conjunction with financial statements, which start on page 8.

Financial Highlights

- LRH net assets increased in 2011 by \$388,055 or 1.1%. In 2010, net assets decreased by \$518,190 or 1.5%. In 2009, net assets increased by \$1,543,210 or 4.7%.
- LRH reported an operating loss in 2011 and 2010 of \$375,668 and \$1,338,049, respectively. In 2009, LRH reported operating income of \$510,892.
- LRH reported non-operating revenues of \$636,370, \$828,755, and \$1,029,366 in 2011, 2010 and 2009, respectively.

Using This Annual Report

LRH financial statements consist of three statements—a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of LRH, including resources held by LRH but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

Analysis of LRH finances starts on page 8. The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about LRH resources and activities in a way that helps answer whether LRH, as a whole, is better or worse off from this year's activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report LRH net assets and changes in them. Increases or decreases in net assets are an indicator of whether its financial health is improving or deteriorating. To assess the health of LRH, non-financial factors, such as changes in the patient base of LRH and measures of the quality of service it provides to the community, and local economic factors need to be considered.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It shows where cash came from and what the cash was used for. It also provides the change in cash balance during the reporting period.

Net Assets

LRH net assets are the difference between assets and liabilities reported in the Balance Sheet on page 8. LRH net assets increased this past year by \$388,055 or 1.1%, as shown in Table 1. This compares to a decrease in 2010 of \$518,190 and an increase of \$1,543,210 in 2009.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2011 and 2010

Table 1: Assets, Liabilities, and Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011 Change</u>
Assets:				
Current assets	\$ 24,455,277	23,524,541	23,549,779	4.0%
Capital assets, net	14,324,000	14,193,206	14,962,652	0.9%
Other non-current assets	<u>2,771,883</u>	<u>3,222,271</u>	<u>3,190,490</u>	<u>-14.0%</u>
Total assets	<u>41,551,160</u>	<u>40,940,018</u>	<u>41,702,921</u>	<u>1.5%</u>
Liabilities:				
Long-term debt outstanding	3,625,000	3,905,000	4,175,000	-7.2%
Other current and noncurrent liabilities	<u>3,518,487</u>	<u>3,015,400</u>	<u>2,990,112</u>	<u>16.7%</u>
Total liabilities	<u>7,143,487</u>	<u>6,920,400</u>	<u>7,165,112</u>	<u>3.2%</u>
Net assets:				
Invested in capital assets, net of related debt	10,419,000	10,018,206	10,527,652	4.0%
Restricted for debt service	258,530	250,704	287,045	3.1%
Restricted expendable net assets	304,493	190,535	195,260	59.8%
Restricted nonexpendable net assets	25,000	25,000	25,000	0.0%
Unrestricted	<u>23,400,650</u>	<u>23,535,173</u>	<u>23,502,849</u>	<u>-0.6%</u>
Total net assets	<u>\$ 34,407,673</u>	<u>34,019,618</u>	<u>34,537,806</u>	<u>1.1%</u>

In 2011, LRH net assets increased by \$388,055 or 1.1%, as shown in Table 2. This increase is due to an increase in total operating revenue of \$2,459,345 or 10.4% in 2011, while operating expenses increased \$1,496,964 or 6.0%. Non-operating revenue decreased \$192,385 or 23.2% due to a decline in interest rates on cash and investments and a loss on the disposal of fixed assets.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2011 and 2010

Table 2: Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011 Change</u>
Operating Revenue:				
Net patient service revenue	\$ 26,521,963	24,355,795	26,084,579	8.9%
Provision for bad debt	(1,327,960)	(1,423,356)	(1,389,320)	-6.7%
Other operating revenues	813,689	591,645	555,228	37.5%
Net assets released for operations	<u>2,039</u>	<u>26,302</u>	<u>10,590</u>	<u>-92.2%</u>
Total operating revenue	<u>26,009,731</u>	<u>23,550,386</u>	<u>25,261,077</u>	<u>10.4%</u>
Operating Expenses:				
Salaries and benefits	13,181,923	13,095,524	12,882,102	0.7%
Purchased services and other	10,999,192	9,430,973	9,404,956	16.6%
Depreciation and amortization	2,001,534	2,146,102	2,235,728	-6.7%
Interest	<u>202,750</u>	<u>215,836</u>	<u>227,401</u>	<u>-6.1%</u>
Total operating expenses	<u>26,385,399</u>	<u>24,888,435</u>	<u>24,750,187</u>	<u>6.0%</u>
Operating income (loss)	<u>(375,668)</u>	<u>(1,338,049)</u>	<u>510,890</u>	<u>-71.9%</u>
Non-operating Revenues and Expenses				
Property taxes	350,000	350,000	350,000	0.0%
Investment income	332,472	474,496	687,013	-29.9%
Non-capital grants and contributions	0	525	1,440	-100.0%
Other non-operating revenue and expenses, net	<u>81,251</u>	<u>(5,162)</u>	<u>(6,135)</u>	<u>-1674.0%</u>
Total non-operating revenue, net	<u>763,723</u>	<u>819,859</u>	<u>1,032,318</u>	<u>-6.8%</u>
Increase (decrease) in net assets	<u>388,055</u>	<u>(518,190)</u>	<u>1,543,208</u>	<u>-174.9%</u>
Net assets beginning of year	<u>34,019,618</u>	<u>34,537,808</u>	<u>34,537,799</u>	<u>-1.5%</u>
Net assets end of year	<u>\$ 34,407,673</u>	<u>34,019,618</u>	<u>36,081,007</u>	<u>1.1%</u>

Operating Income (Loss)

The first component of the change in LRH net assets is its operating income (loss), the difference between net patient service revenues and the expenses incurred to perform those services. LRH incurred an operating loss this year largely due to a continued downward trend with inpatient volumes combined with increasing drug costs due to market supply issues.

The primary components affecting operating income (loss) are:

- Net patient revenue increased \$2,261,564 or 9.9% in 2011, compared to a decrease of \$1,728,784 or 6.6% in 2010 and an increase of \$1,329,085 or 5.4% in 2009. Factors contributing to the increase in revenues consisted of growth in outpatient volumes combined with increased Medicare reimbursements as a result of temporary legislation passed through the Patient Protection and Affordable Care Act in March of 2010.
- Salary and benefit costs for employees increased \$86,399 or .7% in 2011, compared to an increase of \$213,422 or 1.7% in 2010, and an increase of \$586,593 or 4.8% in 2009. The 2011 change was a combination of annual wage increases offset by favorable claims experience from the self-funded Health Care Plan (See Note 11).

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2011 and 2010

- Medical supply and drug costs increased \$985,094 or 17% in 2011, compared to a decrease of \$212,136 or 3.5% in 2010, and an increase of \$464,322 or 8.4% in 2009.
- Acute care patient days were 3,396 in 2011, compared to 3,358 in 2010 and 4,800 in 2009.

The ability to collect the revenue charged to patients affects net patient revenue. The provision for bad debt in 2011 was \$1,327,960, a 6.7% decrease from 2010. This decrease reflects LRH's continued emphasis on the revenue collection cycle.

The rate of healthcare inflation has a direct impact on the cost of services provided by LRH. A component of LRH costs are expenses for medical supplies and prescription drugs. In 2011, medical supplies and prescription drugs cost \$6,781,395, which was a 17% increase from 2010. This increase is the combination of the inflation impact on prices as a result of rising production costs and supply shortages, combined with increased outpatient volumes. In 2010, medical supplies and prescription drugs cost \$5,796,301. In 2009 medical supplies and prescription drugs cost \$6,008,437.

LRH at times provides care for patients who have little or no health insurance or other means of repayment. The level of services provided to these patients was \$367,232 in 2011 compared to \$331,967 in 2010 and \$100,008 in 2009. Because there is no expectation of repayment, charity care is not reported as patient service revenues of LRH.

Non-operating Revenue and Expenses

Non-operating revenue consist of taxes levied by LRH for the ambulance service, and investment earnings. The county tax levy was \$0.18613 per \$1,000 of valuation for 2011, \$0.19187 in 2010 and \$0.19189 in 2009. The county tax levy amounted to \$350,000 in 2011, 2010, and 2009 respectively. Investment income for 2011 was \$332,472, a 29.9% reduction over the \$474,496 of investment income in 2010. Investment income for 2009 was \$687,013.

Cash Flows

Changes in cash flows are consistent with changes in operating income (loss) and non-operating revenues and expenses, discussed earlier. Cash flows provided by investing activities was \$3,080,099 in 2011. A continued decline in short-term investment rates resulted in LRH modifying investment strategies to carry an increase amount of cash in a higher yielding checking account. Cash related expenditures for capital exceeded non-cash expenses for depreciation and amortization by \$338,099 during the year.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2011 LRH had \$14,324,000 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2010, LRH had \$14,193,206 invested in capital assets, net of accumulated depreciation. In 2011, LRH purchased new capital assets costing \$2,233,971. Capital spending was \$1,375,172 and \$1,295,271 in 2010 and 2009, respectively. The increase in capital assets was directly associated with new construction projects as detailed in Note 5.

Debt

At year-end, LRH had \$3,905,000 in capital loan notes outstanding. No new debt was issued in 2011, 2010 or 2009.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2011 and 2010

Other Economic Factors

Inflation continued in 2011 with supply and equipment costs increasing at market rates and the pressure on nursing and other salary costs being driven by the shortage of supply of these health care professionals, and the result of union contracts that represent employees of various departments.

The 2011 fiscal year provided LRH with temporary relief as it pertained to Medicare reimbursement levels due to favorable legislation within the Patient Protection and Affordable Care Act. A continued recessionary economy caused inpatient volumes to remain lower than historical levels.

Contacting LRH Financial Management

This financial report is designed to provide patients, suppliers, taxpayers, and creditors with a general overview of LRH finances. Questions about this report or requests for more information should be directed to:

Steve Alger
Chief Financial Officer
Lakes Regional Healthcare
Highway 71 South
Spirit Lake, Iowa 51360
712-336-8796

Lakes Regional Healthcare

Balance Sheets June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,834,629	9,543,535
Certificates of deposit	6,359,592	8,663,925
Assets limited as to use - required for current debt service	258,530	250,704
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,402,759 in 2011 and \$1,415,619 in 2010	3,494,376	3,560,923
Succeeding year property tax	350,000	350,000
Other	264,729	298,326
Inventories	732,527	678,078
Prepaid expenses	140,720	175,050
Estimated third-party payor settlements	20,174	4,000
Total current assets	<u>24,455,277</u>	<u>23,524,541</u>
Assets limited as to use:		
By Board for -		
Capital improvements	--	477,529
Endowments	2,631,234	2,605,559
By Donor	126,892	124,175
	<u>2,758,126</u>	<u>3,207,263</u>
Capital assets, net of accumulated depreciation	<u>14,324,000</u>	<u>14,193,206</u>
Other assets, net	<u>13,757</u>	<u>15,008</u>
Total assets	<u>\$ 41,551,160</u>	<u>40,940,018</u>

See notes to financial statements

Lakes Regional Healthcare

Balance Sheets (Continued) June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	\$ 280,000	270,000
Accounts payable -		
Trade	709,944	558,794
Construction	354,753	43,374
Salaries, wages and accrued vacation payable	1,164,544	1,415,739
Payroll taxes withheld and accrued	220,242	124,262
Accrued interest payable	15,663	16,746
Other accrued liabilities	423,341	236,485
Deferred revenue for succeeding year property tax receivable	<u>350,000</u>	<u>350,000</u>
Total current liabilities	3,518,487	3,015,400
Long-term debt, net of current portion	<u>3,625,000</u>	<u>3,905,000</u>
Total liabilities	<u>7,143,487</u>	<u>6,920,400</u>
Net assets:		
Invested in capital assets, net of related debt	10,419,000	10,018,206
Restricted -		
For debt service	258,530	250,704
Expendable for capital acquisitions & operating activities	304,493	190,535
Nonexpendable	25,000	25,000
Unrestricted	<u>23,400,650</u>	<u>23,535,173</u>
Total net assets	<u>34,407,673</u>	<u>34,019,618</u>
Total liabilities and net assets	<u>\$ 41,551,160</u>	<u>40,940,018</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Revenue, Expenses and Changes in Net Assets For the Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 26,521,963	24,355,795
Provision for bad debt	<u>(1,327,960)</u>	<u>(1,423,356)</u>
Net patient service revenue	25,194,003	22,932,439
Other revenue	813,689	591,645
Net assets released for operations	<u>2,039</u>	<u>26,302</u>
Total revenue	<u>26,009,731</u>	<u>23,550,386</u>
OPERATING EXPENSES:		
Salaries	10,462,552	10,185,614
Employee benefits	2,719,371	2,909,910
Purchased services and professional fees	3,457,966	2,866,223
Utilities	516,876	542,787
Supplies and other expenses	6,781,395	5,796,301
Depreciation and amortization	2,001,534	2,146,102
Insurance	242,955	225,662
Interest	<u>202,750</u>	<u>215,836</u>
Total expenses	<u>26,385,399</u>	<u>24,888,435</u>
OPERATING LOSS	<u>(375,668)</u>	<u>(1,338,049)</u>
NONOPERATING REVENUE, NET:		
Investment income	332,472	474,496
County tax revenue	350,000	350,000
Unrestricted gifts, grants and bequests	--	525
Gain (loss) on disposal of property and equipment	<u>(46,102)</u>	<u>3,734</u>
Nonoperating revenue, net	<u>636,370</u>	<u>828,755</u>
EXCESS REVENUE OVER (UNDER) EXPENSES BEFORE GRANTS AND CONTRIBUTIONS	260,702	(509,294)
GRANTS, CONTRIBUTIONS AND AUXILIARY ACTIVITY, NET	<u>127,353</u>	<u>(8,896)</u>
INCREASE (DECREASE) IN NET ASSETS	388,055	(518,190)
NET ASSETS, beginning of year	<u>34,019,618</u>	<u>34,537,808</u>
NET ASSETS, end of year	<u>\$ 34,407,673</u>	<u>34,019,618</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows

For the Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 25,244,376	23,052,616
Cash paid to employees for salaries and benefits	(13,337,138)	(13,059,129)
Cash paid to suppliers and contractors	(10,680,570)	(9,231,102)
Other receipts and payments, net	<u>973,960</u>	<u>417,637</u>
Net cash provided by operating activities	<u>2,200,628</u>	<u>1,180,022</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	350,000	350,000
Unrestricted gifts, grants and bequests	<u>--</u>	<u>525</u>
Net cash provided by noncapital financing activities	<u>350,000</u>	<u>350,525</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(1,865,800)	(1,358,804)
Payments on long-term debt	(270,000)	(260,000)
Interest paid on long-term debt	<u>(203,833)</u>	<u>(216,879)</u>
Net cash used in capital and related financing activities	<u>(2,339,633)</u>	<u>(1,835,683)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from (deposits to) assets limited as to use, net	445,090	(7,369)
Withdrawals from (deposits to) certificates of deposit, net	2,304,333	(237,302)
Interest on investments	<u>330,676</u>	<u>473,621</u>
Net cash provided by investing activities	<u>3,080,099</u>	<u>228,950</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,291,094	(76,186)
CASH AND CASH EQUIVALENTS - Beginning of year	<u>9,543,535</u>	<u>9,619,721</u>
CASH AND CASH EQUIVALENTS - End of year	\$ <u><u>12,834,629</u></u>	<u><u>9,543,535</u></u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows (Continued) For the Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	\$ (375,668)	(1,338,049)
Adjustments to reconcile operating loss to net cash provided by operating activities -		
Depreciation and amortization	2,001,534	2,146,102
Interest expense	202,750	215,836
(Increase) decrease in current assets -		
Receivables -		
Patients	66,547	231,812
Other	33,597	(202,092)
Inventories	(54,449)	19,446
Prepaid expenses	34,330	104,846
Estimated third-party payor settlements	(16,174)	(4,000)
Increase (decrease) in current liabilities -		
Accounts payable	151,150	21,357
Due to restricted funds	124,635	1,782
Salaries, wages and accrued vacation payable	(251,195)	83,042
Payroll taxes withheld and accrued	95,980	(46,647)
Other accrued liabilities	187,591	54,222
Estimated third-party payor settlements	--	(107,635)
Net cash provided by operating activities	\$ <u>2,200,628</u>	<u>1,180,022</u>

See notes to financial statements

Lakes Regional Healthcare

Notes to Financial Statements

For the Years Ended June 30, 2011 and 2010

(1) Description of Reporting Entity and Summary of Significant Accounting Policies

The following describes the reporting entity and is a summary of significant accounting policies of Lakes Regional Healthcare (Hospital). These policies are in accordance with accounting principles generally accepted in the United States of America. The Hospital is a county public hospital organized under Chapter 347 of the Code of Iowa and governed by a seven member Board of Trustees elected for terms of six years.

A. *Reporting Entity*

For financial reporting purposes, the Hospital has included all funds, organizations, account groups, agencies, boards, commissions and authorities. The Hospital has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Hospital are such that exclusion would cause the Hospital's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Hospital to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Hospital. The Hospital has no component units which meet the Governmental Accounting Standards Board criteria.

B. *Industry Environment*

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that the Hospital is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made which are expected to have a material effect on the Hospital's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

As a result of recently enacted federal healthcare reform legislation, substantial changes are anticipated in the United States healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement of healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over approximately the next decade.

C. *Basis of Presentation*

The balance sheets display the Hospital's assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets consist of nonexpendable and expendable net assets. Nonexpendable net assets are subject to externally imposed stipulations which require them to be maintained permanently by the Hospital. Expendable net assets result when constraints placed on net assets use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

Unrestricted net assets consist of net assets not meeting the definition of the two preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Hospital's policy to use restricted resources first.

D. Measurement Focus and Basis of Accounting

Basis of accounting refers to when revenue and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenue is recognized when earned and expenses are recorded when the liability is incurred.

In reporting the financial activity of its proprietary funds, the Hospital applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

E. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

F. Cash and Cash Equivalents

Cash and cash equivalents for purposes of the statements of cash flows include investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts limited as to use by donor and bond indenture agreements.

G. Patient Receivables

Patient receivables are uncollateralized customer and third-party payor obligations. Unpaid patient receivables are not assessed interest.

Payments of patient receivables are allocated to the specific claim identified on the remittance advice. If unspecified, payments of patient receivables are allocated to unpaid accounts.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

H. Inventory

Inventory is valued at historical cost using the first-in, first-out method.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

I. Assets Limited as to Use

By Board of Trustees - Periodically, the Hospital's Board of Trustees has set aside assets for future capital improvements and endowments received. The Board retains control over these assets and may, at its discretion, subsequently use them for other purposes.

Under Public Hospital Revenue Capital Loan Notes Agreements - These funds are used for the payment of principal and interest on the notes and to provide funds for the construction of additions to and remodeling of the existing Hospital facilities.

By Donor – These funds are restricted for specified purposes as directed by the grantor or donor.

J. Restricted Assets

Restricted assets consist primarily of funds designated by the donor or grantor for specified purposes.

K. Property Tax Receivable

Property tax receivable is recognized on the levy or lien date, which is the date the tax asking is certified by the County Board of Supervisors. Delinquent property tax receivable represents unpaid taxes for the current and prior years. The succeeding year property tax receivable represents taxes certified by the Board of Trustees to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. By statute, the Board of Trustees is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

L. Capital Assets

Capital asset acquisitions in excess of \$1,500 are capitalized and recorded at cost. Depreciation is provided over the estimated life of each depreciable asset and is computed using the straight-line method.

Useful lives are determined using guidelines from the American Hospital Association Guide for Estimated Useful Lives of Depreciable Hospital Assets. Lives range by capital asset classification as follows:

Land improvements	10 to 50 years
Buildings and building improvements	10 to 50 years
Equipment, computers, and furniture	3 to 25 years

M. Bond Financing Costs

Bond financing costs related to the issuance of the Public Hospital Revenue Capital Loan Notes are included with other assets in the balance sheet and are being amortized over the life of the related notes on a straight-line basis. Amortization expense of \$1,251 for 2011 and 2010 is included in the accompanying statements of revenues, expenses and changes in net assets.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

N. Compensated Absences

Sick leave does not vest and is accounted for as an expenditure or an expense when it is paid. Vacation leave vests and may be carried forward by an employee in an amount not to exceed 480 hours. Vacation expense is accrued as an expense and a liability as it is earned. Vacation leave expenditures are recognized to the extent it is paid during the year and the vested amount is recorded as a current liability. Accrued vacation leave payable at June 30, 2011 and 2010 was \$826,474 and \$742,298, respectively.

O. Deferred Revenue

Although certain revenues are measurable, they are not available. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue represents the amount of assets that have been recognized but the related revenue has not been recognized since the assets are not collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue consists of the succeeding year property tax receivable.

P. Statement of Revenue, Expenses and Changes in Net Assets

For purposes of display, transactions deemed by management to be on-going, major or central to the provision of health care services are reported as operating revenue and expenses. Property tax levied to finance the current year is included in nonoperating revenues and peripheral or incidental transactions are reported as nonoperating revenues and expenses.

Q. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

R. Grants and Contributions

From time to time, the Hospital receives grants and contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted are reported as nonoperating revenues. Amounts restricted to capital acquisitions or that are restricted to a specific operating purpose are reported after nonoperating revenues and expenses.

S. Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Revenue from services to these patients is automatically recorded in the accounting system at the established rates, but the Hospital does not pursue collection of the amounts. The resulting adjustments are recorded as adjustments to patient service revenue at the time of the charity determination.

T. Group Health Insurance Costs

The Hospital is partially self-insured under its employee group health program (effective July 1, 2010), up to certain limits. Included in the employee benefits expense on the accompanying consolidated statements of operations is a provision for premiums for excess coverage and payments for claims including estimates of the ultimate costs for both reported claims and claims

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

incurred but not yet reported at year-end. A liability for unpaid claims is included in other accrued liabilities on the accompanying consolidated balance sheets in the amount of \$189,004 at June 30, 2011.

U. Subsequent Events

The Hospital considered events occurring through October 14, 2011 for recognition or disclosure in the financial statements as subsequent events. That date is the date the financial statements were available to be issued.

(2) Cash and Investments

The Hospital's deposits in banks at June 30, 2011 and 2010 were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Hospital is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high-rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; and certain joint investment trusts, and warrants or improvement certificates of a drainage district.

The Hospital's investments are categorized to give an indication of the level of risk assumed by the Hospital at year end. The Hospital's investments are all category 1 which means that the investments are insured or registered or the securities are held by the Hospital or its agent in the Hospital's name. The Hospital had no investments as defined by Government Accounting Standards Board Statement 3 at June 30, 2011 and 2010.

(3) Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare. Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are paid based on ambulatory payment classifications or fee schedule amounts. Home health services are paid at prospectively determined rates per episode of care. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor.

The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2009.

Medicaid. Inpatient acute services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services related to Medicaid beneficiaries are paid based on ambulatory patient classifications or fee schedule amounts.

The Hospital has also entered into payment agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these agreements primarily includes discounts from established charges. The 2011 and 2010 net patient service revenue increased approximately \$216,000 and \$151,000, due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

(4) Assets Limited as to Use

By Board

Cash deposits and certificates of deposit designated by the Board for future capital improvements and endowments as of June 30, 2011 and 2010, are summarized as follows:

	<u>2011</u>	<u>2010</u>
Capital Improvements -		
Cash	\$ --	1,031
Certificates of deposit	--	476,303
Interest receivable	--	195
	<u>\$ --</u>	<u>477,529</u>
Endowments -		
Cash	\$ 3,294	5,803
Certificates of deposit	2,625,000	2,595,754
Interest receivable	2,940	4,002
	<u>\$ 2,631,234</u>	<u>2,605,559</u>

Hospital Revenue Capital Loan Notes Agreements

In connection with the issuance of Lakes Regional Healthcare Revenue Capital Loan Notes, Series 2002, the Hospital is required to maintain the following funds:

Bond Fund – Established for the monthly deposit by the Hospital of 1/12th of the next annual principal payment and 1/6th of the next semi-annual interest payment (Series 2002).

The amounts as of June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Bond Fund, cash	\$ <u>258,530</u>	<u>250,704</u>

By Donor

The Mandelbaum Endowment Fund consists of a bequest of \$25,000 received in June 1988. The principal amount of \$25,000 is to remain intact with the interest earned to be used for nurse training.

The Hospital Auxiliary conducts various projects to raise funds which are used to satisfy needs of the Hospital as determined by its executive Board and the Hospital Board of Trustees.

The amounts segregated as of June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospital auxiliary assets, primarily cash and temporary cash investments	<u>101,892</u>	<u>99,175</u>
	<u>\$ 126,892</u>	<u>124,175</u>

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

(5) Capital Assets

Capital assets activity for the years ended June 30, 2011 and 2010 were as follows:

	June 30, 2010	Additions	Transfers and Disposals	June 30, 2011
Capital assets, not being depreciated:				
Land	\$ 722,552	195,925	--	918,477
Construction in progress	22,923	585,734	--	608,657
Total capital assets, not being depreciated	745,475	781,659	--	1,527,134
Capital assets, being depreciated:				
Land improvements	622,173	1,551	--	623,724
Hospital buildings	14,552,791	311,937	(21,665)	14,843,063
Medical Office building	3,801,026	10,600	--	3,811,626
Fixed equipment	3,739,945	153,201	(307,137)	3,586,009
Major moveable equipment	13,224,286	975,023	(1,027,061)	13,172,248
Total capital assets, being depreciated	35,940,221	1,452,312	(1,355,863)	36,036,670
Less accumulated depreciation:				
Land improvements	339,210	25,647	--	364,857
Hospital buildings	7,198,324	561,749	(15,800)	7,744,273
Medical Office building	2,096,084	130,707	--	2,226,791
Fixed equipment	3,129,902	100,749	(272,713)	2,957,938
Major moveable equipment	9,728,970	1,181,431	(964,456)	9,945,945
Total accumulated depreciation	22,492,490	2,000,283	(1,252,969)	23,239,804
Total capital assets, being depreciated, net	13,447,731	(547,971)	(102,894)	12,796,866
Total capital assets, net	\$ 14,193,206	233,688	(102,894)	14,324,000
	June 30, 2009	Additions	Transfers and Disposals	June 30, 2010
Capital assets, not being depreciated:				
Land	\$ 722,552	--	--	722,552
Construction in progress	--	22,923	--	22,923
Total capital assets, not being depreciated	722,552	22,923	--	745,475
Capital assets, being depreciated:				
Land improvements	604,298	17,875	--	622,173
Hospital buildings	14,531,141	21,650	--	14,552,791
Medical Office building	3,801,026	--	--	3,801,026
Fixed equipment	3,666,869	82,576	(9,500)	3,739,945
Major moveable equipment	12,154,590	1,230,148	(160,452)	13,224,286
Total capital assets, being depreciated	34,757,924	1,352,249	(169,952)	35,940,221
Less accumulated depreciation:				
Land improvements	311,945	27,265	--	339,210
Hospital buildings	6,635,059	563,265	--	7,198,324
Medical Office building	1,959,897	136,187	--	2,096,084
Fixed equipment	3,020,569	109,333	--	3,129,902
Major moveable equipment	8,590,354	1,308,801	(170,185)	9,728,970
Total accumulated depreciation	20,517,824	2,144,851	(170,185)	22,492,490
Total capital assets, being depreciated, net	14,240,100	(792,602)	233	13,447,731
Total capital assets, net	\$ 14,962,652	(769,679)	233	14,193,206

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

Construction in progress for the Hospital as of June 30, 2011 consists of Phase 1 of a multi-phase master facility plan. Phase 1 involves transforming the former education center consisting of approximately 3,440 square feet into new physical therapy and occupational therapy departments. In addition, approximately 4,100 square feet of previously undeveloped first floor space will become a clinic space rented to a local orthopedic group. Expected completion of Phase I is scheduled for early October of 2011. The estimated cost of Phase 1 is \$1.4 million.

(6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2011 and 2010 consisted of the following:

	<u>June 30, 2010</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2011</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 4,175,000	--	270,000	3,905,000	280,000

	<u>June 30, 2009</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2010</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 4,435,000	--	260,000	4,175,000	270,000

- (A) On May 6, 2002, \$8,000,000 of Hospital Revenue Capital Loan Notes were issued by the Hospital pursuant to the provisions of Chapter 331 and 347 of the Code of Iowa, as amended, and in conformity with a resolution of the Lakes Regional Healthcare Board of Trustees, and, as such, the Hospital has pledged future revenues, net of specified operating expenses, to repay the bonds. The proceeds of the Notes were used to retire the outstanding principal amount of Public Hospital Revenue Capital Loan Notes, Series 1993(B), and provide funds for the construction of additions to and remodeling of the existing Hospital facilities. The interest rate on the notes is 4.88% and will reset on June 1 of the years 2012 and 2017 at the rate equal to the five-year United States Treasury Note Index plus .25%.

Annual debt service requirements related to the Notes assuming a 4.88% interest rate are as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	4.88	\$ 280,000	192,512	472,512
2013	4.88	295,000	178,708	473,708
2014	4.88	310,000	164,165	474,165
2015	4.88	320,000	148,882	468,882
2016	4.88	335,000	133,107	468,107
2017 – 2021	4.88	1,925,000	401,539	2,326,539
2022	4.88	440,000	21,691	461,691
		<u>\$ 3,905,000</u>	<u>1,240,604</u>	<u>5,145,604</u>

Under the terms of the Notes Agreements, the Hospital is required to maintain certain funds which are included in the assets whose use is limited in the financial statements.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

The Hospital recognized interest expense of \$202,750 and \$215,836 during the years ended June 30, 2011 and 2010, respectively.

(7) Professional Liability Insurance

The Hospital carries a professional liability policy (including malpractice) providing coverage of \$1,000,000 for injuries per occurrence and \$3,000,000 aggregate coverage. In addition, the Hospital carries an umbrella policy which also provides \$2,000,000 per occurrence and aggregate coverage. These policies provide coverage on a claims-made basis covering only those claims which have occurred and are reported to the insurance company while the coverage is in force. The Hospital could have exposure on possible incidents that have occurred for which claims will be made in the future should professional liability insurance not be obtained, should coverage be limited and/or not available.

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probably ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made.

(8) Employee Retirement and Defined Benefit Pension Plan

The Hospital contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa 50360-9117.

Plan members are required to contribute 4.50% of their annual salary and the Hospital is required to contribute 6.95% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2011, 2010 and 2009 were \$710,995, \$658,685, and \$615,405, respectively, equal to the required contributions for each year.

(9) Rental Income

The Hospital is the lessor of certain office space leased under various noncancelable operating leases through 2021. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2012	\$	72,603
2013		64,125
2014		64,125
2015		64,125
2016		64,125
2017 - 2021		288,563

(10) Contingencies

The Hospital is involved in litigation arising in the normal course of business. These claims are covered under policies of their previous insurance carrier. After consultation with legal counsel, management estimates these matters will be resolved without material adverse affect on the Hospital's future financial position or results from operations.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

(11) Health Insurance Agreement

The Hospital established a partially self-funded Health Care Plan effective July 1, 2010 with Wellmark Blue Cross and Blue Shield (BCBS). It was established for the benefit of eligible employees and their dependents. The Hospital is self-insured for health claims of participating employees and dependants up to an annual aggregate amount of \$50,000 per covered person. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount.

(12) Concentrations of Credit Risk

The Hospital is located in Spirit Lake, Iowa. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	<u>2011</u>	<u>2010</u>
Medicare	32.7%	31.5%
Medicaid	4.1	4.6
Blue Cross	17.9	16.6
Private pay	29.9	31.4
Other third-party payors	<u>15.4</u>	<u>15.9</u>
	<u>100.0%</u>	<u>100.0%</u>

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. These risks are covered by commercial insurance purchased from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

Lakes Regional Healthcare

Budgetary Comparison Schedule of Revenues, Expenses and Changes in Net Assets – Budget and Actual (Cash Basis) June 30, 2011 and 2010

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences resulting from the Hospital preparing a budget on the cash basis of accounting.

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Hospital on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures.

For the year ended June 30, 2011, the Hospital's expenditures did not exceed the amount budgeted.

The following is a reconciliation between reported amounts and cash disbursements and a comparison to budget:

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budgeted Amounts	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 350,000	-	350,000	344,735	5,265
Estimated other revenues / receipts	26,423,454	127,765	26,551,219	26,454,165	97,054
	26,773,454	127,765	26,901,219	26,798,900	102,319
Expenses / Disbursements	26,385,399	(35,025)	26,350,374	27,613,600	1,263,226
Net	388,055	162,790	550,845	\$ (814,700)	1,365,545
Balance beginning of year	34,019,619	(12,372,119)	21,647,500		
Balance end of year	\$ 34,407,674	(12,209,329)	22,198,345		

Patient Service Revenue
For the Years Ended June 30, 2011 and 2010

	2011				2010			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	\$ 2,703,862	416,852	--	3,120,714	2,648,830	895,012	--	3,543,842
Swing bed	--	--	289,264	289,264	--	--	286,119	286,119
Observation	85,920	402,151	--	488,071	110,897	348,247	--	459,144
Coronary care	169,606	--	--	169,606	146,196	--	--	146,196
Nursery	175,628	--	--	175,628	193,494	--	--	193,494
	<u>3,135,016</u>	<u>819,003</u>	<u>289,264</u>	<u>4,243,283</u>	<u>3,099,417</u>	<u>1,243,259</u>	<u>286,119</u>	<u>4,628,795</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	1,716,017	6,100,920	14,217	7,831,154	1,585,346	5,463,877	22,706	7,071,929
Pharmacy	1,223,816	4,667,423	226,454	6,117,693	1,221,188	3,951,259	211,018	5,383,465
Central services and supply	2,347,562	1,566,737	7,923	3,922,222	1,981,648	1,359,557	13,778	3,354,983
Emergency and outpatient service	538,484	4,444,655	332	4,983,471	529,714	4,335,589	651	4,865,954
Laboratory	698,057	3,231,876	62,013	3,991,946	702,936	3,106,097	57,777	3,866,810
CT scanner	192,887	1,986,332	5,297	2,184,516	192,865	2,192,726	3,158	2,388,749
MRI	28,516	1,172,553	4,731	1,205,800	23,556	1,243,042	--	1,266,598
Respiratory therapy	537,510	119,174	84,225	740,909	492,765	133,922	118,911	745,598
Physical therapy	154,074	471,105	77,816	702,995	114,866	552,577	55,115	722,558
Radiology	150,778	1,130,810	6,957	1,288,545	151,000	793,609	12,948	957,557
Anesthesiology	301,103	686,396	2,430	989,929	272,310	558,072	3,780	834,162
Ambulance	136,570	1,050,795	1,535	1,188,900	125,348	883,994	4,336	1,013,678
Ultrasound	51,538	683,498	2,208	737,244	53,605	642,709	3,825	700,139
Intravenous therapy	274,100	744,104	9,990	1,028,194	258,528	733,770	10,878	1,003,176
Home Health	--	909,856	--	909,856	--	894,116	--	894,116
Oncology	4,151	603,207	--	607,358	4,620	498,532	470	503,622
Electrocardiology	75,076	247,951	3,102	326,129	66,450	243,903	6,123	316,476
Blood	150,939	115,788	11,723	278,450	168,143	139,494	5,932	313,569
Nuclear medicine	4,317	143,033	--	147,350	4,949	151,449	--	156,398
Public Health	--	265,414	--	265,414	--	326,558	--	326,558
Hospice	621,831	--	--	621,831	557,490	--	--	557,490
Delivery and labor room	137,130	67,561	--	204,691	188,897	45,656	--	234,553
Occupational therapy	43,494	97,660	41,692	182,846	13,506	105,289	7,296	126,091
Cardiac Rehab	--	121,759	--	121,759	--	148,502	--	148,502
Mammogram	674	280,130	--	280,804	520	305,037	--	305,557
Enterostomal therapy	16,200	123,004	8,218	147,422	16,466	113,131	7,016	136,613
Stress testing	1,018	65,801	--	66,819	1,018	63,657	--	64,675
Speech therapy	6,786	44,098	6,133	57,017	6,547	59,100	4,537	70,184
Outpatient Clinic	1,126	254,118	--	255,244	1,868	223,733	--	225,601
Electroencephalography	418	98,095	--	98,513	--	97,980	--	97,980
	<u>9,414,172</u>	<u>31,493,853</u>	<u>576,996</u>	<u>41,485,021</u>	<u>8,736,149</u>	<u>29,366,937</u>	<u>550,255</u>	<u>38,653,341</u>
GROSS PATIENT SERVICE REVENUE	\$ <u>12,549,188</u>	<u>32,312,856</u>	<u>866,260</u>	<u>45,728,304</u>	<u>11,835,566</u>	<u>30,610,196</u>	<u>836,374</u>	<u>43,282,136</u>
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(18,568,930)				(18,347,328)
Charity care services and other discounts, based on charges forgone				(637,411)				(579,013)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT	\$			<u>26,521,963</u>				<u>24,355,795</u>
PROVISION FOR BAD DEBT				(1,327,960)				(1,423,356)
NET PATIENT SERVICE REVENUE	\$			<u>25,194,003</u>				<u>22,932,439</u>

Other Operating Revenue
For the Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Rental income	\$ 303,416	298,796
Medicaid EHR Incentive	175,000	--
Meals sold	153,582	142,108
Lifeline	59,846	63,380
Meals on Wheels	17,429	18,632
Other	92,848	61,164
Dietary instruction	9,434	6,198
Medical record fees	<u>2,134</u>	<u>1,367</u>
	<u>\$ 813,689</u>	<u>591,645</u>

Departmental Expenses
For the Years Ended June 30, 2011 and 2010

	2011				2010			
	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total
NURSING SERVICES:								
Medical and surgical	\$ 1,805,814	8,841	122,970	1,937,625	2,209,665	433	142,789	2,352,887
Administration	504,304	38	6,978	511,320	472,586	--	6,333	478,919
Obstetrics	149,717	6,000	24,726	180,443	154,033	426	27,688	182,147
Coronary care	132,862	37,000	5,342	175,204	13,135	--	12,190	143,505
Nursery	64,882	--	6,950	71,832	66,457	--	9,541	75,998
	<u>2,657,579</u>	<u>51,879</u>	<u>166,966</u>	<u>2,876,424</u>	<u>3,034,056</u>	<u>859</u>	<u>198,541</u>	<u>3,233,456</u>
OTHER PROFESSIONAL SERVICES:								
Central services and supply	59,741	--	1,409,288	1,469,029	56,137	--	1,202,118	1,258,255
Pharmacy	273,557	--	2,450,867	2,724,424	270,095	3,638	1,923,483	2,197,216
Emergency room	611,165	1,436,927	96,656	2,144,748	489,779	1,229,470	46,109	1,765,358
Operating and recovery room	615,695	35,605	292,228	943,528	528,821	4,140	295,113	828,074
Laboratory	507,841	159,236	290,481	957,558	460,604	130,240	293,425	884,269
Ambulance	500,455	200	66,900	567,555	461,008	1,160	61,107	523,275
Physical therapy	60,874	356,641	19,911	437,426	--	291,124	9,119	300,243
Home Health	634,634	66,032	55,933	756,599	585,463	40,048	65,648	691,159
Radiology	346,774	38,817	66,975	452,566	329,890	7,798	59,139	396,827
Medical records	324,937	1,650	68,673	395,260	299,866	16,903	56,300	373,069
Respiratory therapy	131,366	125	37,055	168,546	135,411	--	31,998	167,409
Public health	222,252	2,029	22,373	246,654	225,525	1,190	20,913	247,628
Same day surgery	218,188	1,767	22,684	242,639	183,008	--	22,568	205,576
Hospice	146,946	149,048	53,795	349,789	138,301	150,977	42,112	331,390
CT scanner	89,129	566	156,863	246,558	101,766	904	162,061	264,731
Oncology	120,835	2,599	19,676	143,110	116,809	6,694	17,858	141,361
Blood bank	--	165,032	13,628	178,660	--	12,1835	17,167	139,002
Electrocardiology	96,030	64,196	5,624	165,850	90,560	65,399	7,527	163,486
Nuclear medicine	--	67,402	--	67,402	--	72,432	--	72,432
Quality assurance	64,214	114	6,799	71,127	62,994	--	5,062	68,056
Ultrasound	67,815	114,94	32,767	112,076	48,557	7,432	27,485	83,474
Anesthesiology	--	223,000	71,265	294,265	--	2,381	58,085	60,466
MRI	35,123	30,810	50,001	115,934	51,945	--	36,433	88,378
Delivery and labor room	50,951	--	3,430	54,381	52,188	--	8,016	60,204
Social services	18,119	--	88	18,207	24,689	--	194	24,883
Speech therapy	--	27,167	101	27,268	--	38,020	1,151	39,171
Enterostomal therapy	--	40,246	1,591	41,837	--	39,234	1,698	40,932
Outpatient Clinic	78,756	163	36,685	115,604	79,959	--	20,629	100,588
Stress testing	4,275	--	--	4,275	4,247	--	--	4,247
Electroencephalography	--	43,233	--	43,233	--	60,555	--	60,555
Library	--	--	--	--	--	--	456	456
	<u>5,279,672</u>	<u>2,924,099</u>	<u>5,352,337</u>	<u>13,556,108</u>	<u>4,797,622</u>	<u>2,291,574</u>	<u>4,492,974</u>	<u>11,582,170</u>
GENERAL SERVICES:								
Plant operation and maintenance	375,842	112,845	626,092	1,114,779	305,583	163,873	659,239	1,128,695
Dietary	340,153	5,020	287,574	632,747	338,997	1,713	272,156	612,866
Housekeeping	146,253	910	58,970	206,133	165,165	425	57,442	223,032
Laundry and linen	22,774	58,308	16,585	97,667	19,420	56,955	10,533	86,908
	<u>885,022</u>	<u>177,083</u>	<u>989,221</u>	<u>2,051,326</u>	<u>829,165</u>	<u>222,966</u>	<u>999,370</u>	<u>2,051,501</u>
ADMINISTRATIVE SERVICES	<u>1,640,279</u>	<u>304,905</u>	<u>789,747</u>	<u>2,734,931</u>	<u>1,524,771</u>	<u>350,824</u>	<u>648,203</u>	<u>2,523,798</u>
NONDEPARTMENTAL:								
Employee Benefits	--	--	2,719,371	2,719,371	--	--	2,909,910	2,909,910
Depreciation and amortization	--	--	2,001,534	2,001,534	--	--	2,146,102	2,146,102
Interest	--	--	202,750	202,750	--	--	215,836	215,836
Insurance	--	--	242,955	242,955	--	--	225,662	225,662
	<u>--</u>	<u>--</u>	<u>5,166,610</u>	<u>5,166,610</u>	<u>--</u>	<u>--</u>	<u>5,497,510</u>	<u>5,497,510</u>
TOTAL EXPENSES	<u>\$ 10,462,552</u>	<u>3,457,966</u>	<u>12,464,881</u>	<u>26,385,399</u>	<u>10,185,614</u>	<u>2,866,223</u>	<u>11,836,598</u>	<u>24,888,435</u>

**Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2011 and 2010**

ANALYSIS OF AGING:

Days Since Discharge	2011		2010	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 4,943,321	72.6 %	4,871,506	71.2
61 - 90	350,741	5.2	363,699	5.3
91 - 180	739,397	10.9	688,093	10.1
181 - 364	468,338	6.9	464,315	6.8
> 1 year	302,437	4.4	454,722	6.6
	<u>6,804,234</u>	<u>100.0 %</u>	<u>6,842,335</u>	<u>100.0</u>

Less:

Allowance for doubtful accounts	(1,402,759)	(1,415,619)
Allowance for contractual adjustments	<u>(1,907,099)</u>	<u>(1,865,793)</u>
	<u>\$ 3,494,376</u>	<u>\$ 3,560,923</u>

	2011	2010
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	48.1 days	53.4 days

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

Balance, beginning of year	\$ 1,415,619	1,340,972
Provision of uncollectible accounts	1,327,960	1,423,356
Recoveries of accounts previously written off	267,640	276,115
Accounts written off	<u>(1,608,460)</u>	<u>(1,624,824)</u>
Balance, end of year	<u>\$ 1,402,759</u>	<u>1,415,619</u>

Inventory / Prepaid Expenses
For the Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
INVENTORY:		
Surgical services	\$ 304,642	321,905
Pharmacy	227,492	130,535
Central storeroom	116,538	139,160
Laboratory	26,626	30,112
Fuel oil	25,478	25,950
Dietary	12,029	11,197
Radiology	9,844	10,425
Computers	1,875	2,757
Respiratory therapy/stress testing	<u>8,003</u>	<u>6,037</u>
	<u>\$ 732,527</u>	<u>678,078</u>
 PREPAID EXPENSES:		
Insurance	\$ 67,932	79,468
Maintenance contracts	61,222	92,009
Other	<u>11,566</u>	<u>3,573</u>
	<u>\$ 140,720</u>	<u>175,050</u>

**Financial and Statistical Highlights
For the Years Ended June 30, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
Patient days:		
Adult and pediatric-		
Medicare	2,280	2,247
Other	<u>1,116</u>	<u>1,111</u>
	3,396	3,358
Swing bed - skilled	713	707
Newborn	<u>308</u>	<u>357</u>
Total	<u>4,417</u>	<u>4,422</u>
Patient discharges:		
Adult and pediatric-		
Medicare	554	568
Other	<u>388</u>	<u>393</u>
	942	961
Swing bed - skilled	127	148
Newborn	<u>139</u>	<u>165</u>
Total	<u>1,208</u>	<u>1,274</u>
Average length of stay:		
Adult and pediatric-		
Medicare	4.12 days	3.96 days
Other	2.88 days	2.82 days
Swing bed - skilled	5.61 days	4.78 days
Newborn	2.22 days	2.16 days
Surgical procedures	3,635	3,609
Emergency room visits	6,595	6,395
Number of employees - full-time equivalents	208	208

**Independent Auditor's Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with Government Auditing Standards**

To the Board of Trustees
Lakes Regional Healthcare
Spirit Lake, Iowa:

We have audited the financial statements of Lakes Regional Healthcare (Hospital) as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon, dated October 14, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing our opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility of a material misstatement of the Hospital's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2011 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Hospital. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials, employees and constituents of the Hospital and other parties to whom the Hospital may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Lakes Regional Healthcare during the course of the audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Spim Johnson, LLP

Omaha, Nebraska,
October 14, 2011.

Lakes Regional Healthcare

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2011

Part I: Summary of the Independent Auditor's Results

- a. An unqualified opinion was issued on the financial statements.
- b. No significant deficiencies or material weaknesses in internal control over financial reporting were disclosed by the audit of the financial statements.
- c. The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Findings Related to the Financial Statements

INSTANCES OF NON-COMPLIANCE:

No matters were reported.

INTERNAL CONTROL DEFICIENCIES:

No deficiencies were identified that required disclosure.

Part III: Other Findings Related to Required Statutory Reporting

III-A-11

Certified Budget: Hospital disbursements during the year ended June 30, 2011 did not exceed amounts budgeted.

III-B-11

Questionable Expenditure: We noted no expenditures that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

III-C-11

Travel Expense: No expenditures of Hospital money for travel expenses of spouses of Hospital officials and/or employees were noted.

III-D-11

Business Transactions: No business transactions between the Hospital and Hospital officials and/or employees were noted to violate Chapter 347.15 of the Code of Iowa which limits a trustee's pecuniary interest in the purchase or sale of any commodities or supplies procured for or disposed of by said hospital to \$1,500 without publicly invited and opened written competitive bids.

III-E-11

Board Minutes: No transactions were found that we believe should have been approved in the Board minutes but were not.

III-F-11

Deposits and Investments: No instances of noncompliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Hospital's investment policy were noted.

Lakes Regional Healthcare

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2011

III-G-11

Publication of Bills Allowed and Salaries: Chapter 347.13(14) of the Code of Iowa states in part, "There shall be published quarterly in each of the official newspapers of the county as selected by the board of supervisors pursuant to Section 349.1 the schedule of bills allowed and there shall be published annually in such newspaper the schedule of salaries paid by job classification and category..." We noted no instances of noncompliance with the publication of bills allowed and salaries. The Hospital publishes a list of expenditures quarterly which are summarized by major classification and vendor. They also publish a schedule of salaries annually by category.

Lakes Regional Healthcare

Audit Staff For the Year Ended June 30, 2011

This audit was performed by:

- Roger E. Thompson, FHFMA, CPA, Partner
- Joseph L. Harnisch, CPA, Senior Manager
- Shannon M. Castillo, CPA, Staff Auditor
- Morgan L. Meyer, Staff Auditor